Testimony of Charles Hosken, General Manager
Imperial (CA) Irrigation District
Hearing on Impacts of FY 2007 Budget
On
Federal Power Marketing Administrations
Wednesday, March 1, 2006
Subcommittee on Water and Power

Mr. (or Madame) Chairman and Members of the Subcommittee, my name is Charles Hosken and I am the General Manager of the Imperial Irrigation District (IID). IID is a community-owned utility that provides water and electric power to consumers in southeastern California.

A. Background on IID

IID was established in 1911 under the California Irrigation District Act. Today, IID is the largest irrigation district in the nation. It provides irrigation water to the Imperial Valley, which ranks among the top ten agricultural areas in the country. Ninety-eight percent of the water that IID transports is used for agriculture in the Imperial Valley. The remaining two percent is delivered to seven Imperial Valley cities and to unincorporated residential areas, which treat the water to safe drinking water standards and sell it to their residents.

IID entered into the power business in 1936, when access to electric energy in the Imperial Valley was very limited and very expensive. Today, IID Energy serves more than 130,000 homes, businesses and industries in the Imperial Valley and parts of Riverside and San Diego counties. These areas are experiencing very rapid growth in electrical demand, with growth rates of nine percent in Riverside County and six percent in Imperial County. These are among the highest demand increases in the country.

IID was one of the original contractors for federal power generated from the Parker-Davis Project and has been a Parker-Davis customer continuously since 1948. The Parker-Davis Project consists of the Parker and Davis Dams located on the Colorado River below Hoover Dam. The dams are owned and operated by the US Bureau of Reclamation; power generated from the projects is marketed by the Western Area Power Administration (Western).

IID's allocation of Parker-Davis power is 32 MW, representing approximately five percent of our resource portfolio. Although the Parker-Davis allocation is a relatively small part of IID's total resources, it is one of our lowest cost resources and, as such, is critical to our ability to maintain affordable electric rates.

IID's allocation of Parker-Davis power plays an important role in our local and regional economy. Unemployment in southeastern California is significantly higher than the national average and the per capita income of our customers is low. In addition, the

extreme temperatures in this part of California result in higher per capita energy use than in other parts of the county. For these reasons, IID pays a great deal of attention to proposals to change federal power allocation or repayment policies.

I might add here, on a personal note, that until recently I was the General Manager of the Chelan County (WA) Public Utility District, which is a customer of the Bonneville Power Administration. During my tenure at Chelan, I was engaged in a number of battles with the Office of Management and Budget (OMB) over repayment policies for the power marketing administrations.

B. OMB Announcement of Administration's Intent to Raise Interest Rate on Future PMA Investments

The President's Fiscal Year 2007 budget announces the Administration's intention to require the Western, Southeastern and Southwestern Power Marketing Administrations (PMAs) to change the interest rate they charge for future capital investments in power-related facilities from the "Treasury yield" rate that these PMAs currently use to the "government corporation" rate that entities like Fannie Mae and Ginnie Mae use. This new policy will be applied to new power related investments at projects whose interest rates are not specified in law.

According to Western, the impact of the interest rate increase will be about .4 of one percent. This will translate to an increase in costs to the Parker-Davis Project of about $1.8 million over five years. While the amount of money at stake might seem small, there are very important principles at stake. Those principles are 1) the application of cost-based pricing for federal power; and 2) "truth in borrowing" or "truth in repayment."

C. Fallacies with Administration Plan

The foundation of the federal power program is that power is sold at cost-based rates. The real interest cost to the government for a water or power project is the cost the government incurs when it builds a project.

If a *government corporation*, like Ginnie Mae or Fannie Mae, builds a project, the real interest cost is the *government corporation's* interest rate at the time of construction.

On the other hand, if the *federal government itself* builds a project, such as a water and power project, the real interest cost is the government's borrowing cost at the time of construction.

In the case of new capital investments in the Parker-Davis Project and the other federal power projects that will be affected by this interest rate change, the federal government itself will be the borrower. So, the actual government borrowing rate should apply – not some "proxy" rate as proposed by the Administration.

This change is proposed, apparently, in a scramble for additional revenue. Using the same rationale ("the more cash the better") and applying the same justification for the current proposal, the Administration could just as easily have chosen Wall Street's prime rate or the rate credit card companies charge the government on government-issue credit cards.

To justify the interest rate increase, the Administration notes that the Bonneville Power Administration pays the "government corporation" rate on its new investments. While true, the explanation in no way amounts to a justification for the Administration's proposal. What the Administration failed to say is that the BPA interest rate was part of a package of legislative changes that the Northwest delegation proposed and enacted almost ten years ago, to restructure BPA's overall debt to address concerns about cost recovery. No debt restructuring is involved here, so the BPA example is not relevant. It certainly supplies no rationale for the Administration's proposal to depart from the principles of cost-based pricing for PMAs and the federal government's departure from the principle of "truth in borrowing."

D. Recent OMB Explanations of Change in Administration Policy.

We understand that OMB has recently offered two explanations for its discriminatory treatment of the interest due on federal debt for multi-purpose water projects which were not included in the budget package sent to Congress. First, it argues that the investments should carry a higher risk premium because they depend on a revenue stream for repayment. Second, OMB argues that since PMAs can repay power feature investments early, investments which depend on them for repayment are akin to investments financed through "call" bonds (implying the possibility of early debt retirement). The Treasury currently does not use "call" bonds, but if did, OMB argues that Treasury would have to pay a higher interest premium on them. Thus, OMB argues, power customers should also pay a higher interest rate on investments costs allocated to the power function of multipurpose projects.

Neither argument has anything to do with federal decisions to develop natural resources or the federal government's borrowing cost at the time multipurpose water projects were constructed. They advance never-before-heard theories which are odd, at best, and which read more like after-the-fact attempts to justify the Administration's announced intention of revenue enhancement rather than justifications for determining the interest rate attributable to reimbursable features of multi-purpose water projects.

Multi-purpose water projects are fundamental investments in the nation's infrastructure and natural resources to yield navigation, flood control, irrigation, recreation and power benefits. The decisions to build them are integrated and, once the benefit-cost ratios of their features are established, there is no separate conceptualizing or financing of their component parts. The benefits they produce, including electricity, occur no matter what, and the cost-based rates charged for the power produced removes all market risk of non-sale. Finally, the justification for a higher risk being attributed to power features because a power contractor's contract might be "called" early is nonsensical. Any cancelled

power contract would be replaced immediately by another identical or longer-term power sale contract so the stream of repayment dollars would be identical to the federal government.

E. Recapitulation

What is the rationale for this discriminatory treatment? Essentially, OMB chose to increase interest rates for the Parker Davis and Central Valley Projects because it could.[1] The interest rates for the other projects are set by statute, and OMB could not reach them through an administrative decision.

Recognizing the value of cost-based federal power to consumers, Congress has repeatedly rejected OMB initiatives to change PMA rate-setting policy. This year, OMB is trying a different tack: proposing administrative changes that will not require Congressional approval. We think this sets a very bad precedent for federal power rates, and we encourage this body to reject the proposal.

[1] I would also point out that, in Western's service area, the OMB proposal would only apply to the Parker-Davis Project and the Central Valley Project. It would not apply to the Pick-Sloan Project, to Hoover Dam, to the Colorado River Storage Project or to the Fryingpan-Arkansas Project.